

**Remarks at the  
Australian Institute for International Affairs (WA Branch)  
Luncheon  
May 28, 2009**

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**Thanks for having me here today. It is a pleasure to chat as friends with such an accomplished group. I thought I would touch a bit on the state of play in the US economy as we continue to endure the slowdown from the global financial crisis. I'd like to briefly discuss the state of the US economy, touch on some of the things the still-new Obama Administration is doing on the economy, and then look at what some of our leading economic policymakers see as the outlook for the American economy. I'll try to be brief and leave plenty of time for discussion and questions.**

## **THE US ECONOMY NOW**

**You are probably broadly familiar with the state of the US economy. We entered recession in December 2007, although we didn't know this until late 2008. Since the collapse of**

**Lehman Brothers and the intensification of the global financial crisis in September 2008, the US economy has shrunk sharply. Real GDP dropped at an annualized rate over 6% in the last quarter of 2008 and again in the first quarter of this year – better than Japan, but still not good. GDP is an abstract number; a more concrete figure is that we have lost over 5 million payroll jobs in the US since early 2008. In April alone we saw over 500,000 jobs lost – that sounds bad but that was actually BETTER than previous months. This is an indication that we will almost certainly see unemployment climb beyond its current 8.9%.**

**But there are some encouraging signs. The rate at which the economy is shrinking appears to have slowed. There are signs that demand, in particular household demand, may**

**have stabilized. Consumer spending, which fell off a cliff in the second half of 2008, was actually up in the first quarter of this year. And we hope that as money from the stimulus program reaches consumers, household spending power and consumer sentiment will improve. Unfortunately, the weak labor market and the declines in housing wealth, along with tight credit for consumers, are ongoing drags on consumer spending. And automobile sales remain very weak – not just for General Motors, Ford, and Chrysler; top foreign auto companies like Toyota and Honda have also seen drops in new car sales of 40 to 50 percent, figures brought to life by those sobering photos of hectares of newly imported cars sitting at ports in California, unwanted.**

**The US housing market has been in steady decline for three years, but we see signs it may be bottoming. Sales of existing homes and sales of new homes have shown signs of stabilizing, albeit at depressed levels. Homes, due to declining prices and low 30-year fixed rate mortgages of around 4.8%, are much more affordable, which our experts believe is helping to steady the demand for housing. The backlog of unsold new homes is shrinking, a crucial prerequisite for any recovery in homebuilding.**

**The business news is more troubling. Investment is weak; spending on equipment and software for example both fell 30% in the past six months. Some surveys have been more positive, but reporting firms still see net declines in new orders and little capital spending planned. Similar surveys**

**of bank loan officers shows weaker demand for commercial and industrial loans, and many banks are still practicing much tighter business lending policies than the norm.**

**Commercial property and real estate remain in the doldrums. Vacancy rates for office, industrial, and retail properties are rising, prices are falling, and there are fewer projects being undertaken.**

### **WHAT IS BEING DONE?**

**So, that is the difficult climate in which Barack Obama and his Administration assumed office. The Administration has moved very aggressively to shore up the economy.**

**Within four weeks of taking office, President Obama signed into law a \$787 billion stimulus package. I don't want to say that Barack Obama walks on water, but getting a major**

**piece of legislation like this out of Congress in under four weeks is pretty close to a modern day miracle. This deal included tax cuts for 95% of Americans and increased transfers to households, reduced taxes for businesses, more spending on infrastructure and energy projects, and assistance to state and local governments, much of which will help the states deal with increased burdens on their unemployment and welfare programs. The Congressional Budget Office estimates this will boost real GDP by 1 to 3 percent, which would keep unemployment  $\frac{1}{2}$  to 2 percentage points lower than it would otherwise have been.**

**President Obama and his team were also faced with the troubled giants in our automobile sector. The Administration has set up a Presidential Task Force on the Auto Industry, and has worked closely with General Motors**

**and Chrysler (so far, Ford has been riding out the economic crisis on its own). You have probably read about Chrysler's recent decision to cut about a quarter of its dealers. Without the Administration's support which helped broker the agreement for Chrysler and Fiat to form a new partnership, ALL of Chrysler's dealers may have been closing and Chrysler could have faced liquidation, costing 3200 jobs at Chrysler's dealers alone.**

**GM also announced the closure of many of its dealers. This is part of its effort to achieve financial viability. The President's Auto Task Force is continuing to work with GM and all of its stakeholders and will stand behind GM during this process to ensure that it emerges as a more competitive, viable business in the long-term. And again, without the President's intervention, the entire GM dealer network**

**could have been lost. In addition, the Administration is working to help ensure that financing is available to creditworthy dealers and to help boost domestic demand for cars. Support for the industry also includes the Auto Supplier Support Plan, making up to \$5 billion available to ease credit and liquidity problems for automotive suppliers.**

**The Administration has of course focused a great deal on shoring up the financial sector, which in good times supports the entire economy – and in bad times, well you have seen what can happen. There are several programs that form the Financial Stability Plan, announced in February. One of those is the Capital Assistance Program. This program was designed to that ensure banks have enough capital to lend even in economically troubled times. Part of the CAP were the stress tests – the Supervisory Capital Assessment**

**Program – that each of the 19 largest banking holding companies were subjected to, with results announced in early May. Encouragingly, many of these financial institutions were found to be ready to manage in a serious economic downturn. We are working with the others to ensure they create adequate capital buffers, either with funding from the US government or by raising additional private capital, with the deadline for having a plan in place by mid-November.**

**On March 3 Treasury launched the Consumer and Business Lending Initiative, which included the Term Asset Backed Securities Loan Facility (TALF), making loans available for purchasers of top-rated securities backed by credit card, small business, auto, and student loans. This was designed to help improve conditions in the credit markets by**

**addressing securitization markets that had nearly ground to a halt. Results have been encouraging – purchasers of these assets include many serious investors, showing progress in restoring markets. Since March 3, we have seen significant declines in the spreads on securities based on auto, credit card, and student loans. This shows up in the real economy – new car loan rates at auto finance companies have dropped from 8.4% in December to around 3% now, and over March and April we saw \$10 billion in consumer-backed asset securities, more than the previous five months combined.**

**On March 23 the Treasury introduced the Public-Private Investment Program. The goal of the PPIP is to reduce the troubled legacy assets encumbering the balance sheets of financial institutions. It features private sector investment along with the funds from the US taxpayer. This will**

**strengthen banks and in the end, bring profits to the private and public holders of these assets.**

**There are two parts to the program: the Legacy Loans Program and the Legacy Securities Program.**

**The Federal Deposit Insurance Corporation (FDIC) and the Treasury Department will operate the Legacy Loans Program, which will help cleanse bank sheets of troubled legacy loans by facilitating the creation of individual Public Private Partnership funds which will purchase pools of eligible loans from participating banks. Under the program, banks will identify the assets they wish to sell, the FDIC will conduct an auction for pools of loans, and the highest bidder will have access to both government equity funding and FDIC-guaranteed financing. So, for example, a bank could**

**identify a pool of residential mortgages with a \$100 face value, which could be auctioned to the highest bidder for, say, \$84. The winning bidder would form a Public-Private Partnership Fund, contribute \$6 in equity, which would be matched by \$6 in equity funding from the Treasury, with the remaining \$72 financed with FDIC-guaranteed loans. The private investor would manage the servicing of the asset pool and the timing of its disposition under FDIC oversight.**

**The Federal Reserve Board and the Treasury will operate the Legacy Securities Program, which is designed to restart the market for securities tied to residential and commercial real estate. Fund managers have already submitted proposals to raise private capital to participate in joint investment programs with Treasury. The Government will provide one-for-one match for every dollar of private capital**

**that a pre-qualified fund manager raises and provide debt financing for up to 100% of total equity capital. Thus, a fund manager who raises \$100 in private capital will receive \$100 in equity financing from Treasury and up to \$200 in loans. The manager would then commence a purchase program for targeted securities and have full discretion in investment decisions, while following a long-term buy and hold strategy.**

**Through the Capital Purchase Program, established last October, Treasury has given viable financial institutions of all sizes an optional extra layer of capital for to help support lending. Treasury has invested capital in the form of preferred stock in 579 institutions, including over 300 small banks. The Administration has also launched programs**

**designed to reduce foreclosures for home owners and to support credit for small businesses.**

**Additionally, the Obama Administration has played a leading role in the international response to the global financial crisis. The London G20 meeting agreed to work with the private sector to reduce troubled assets at banks, something the President and Prime Minister Rudd pushed at London. The Administration has been forthright in rejecting calls for protectionism. This is not the time to turn inward, and we have been strong in pushing that message. We also agreed that we should all improve the transparency and capital protections for financial systems.**

**Secretary Geithner has described in outline the comprehensive regulatory reform efforts the Administration will propose in coming weeks. The focus initially has been on addressing systemic risk – to make those risks less threatening to stability, and to ensure the Federal government has the tools to contain the damage they could inflict on the economy. The goal is to bring markets where financial institutions come together, such as the derivatives market, under a better oversight framework. This is being done with the recognition that capital, liquidity, and risk management requirements must be greater for the largest and most interconnected institutions, with the greater potential threat their failure would pose to the financial system. These requirements are more about ensuring the stability of the entire financial system than merely ensuring the soundness of an individual financial institution. The**

**changes the President and Secretary Geithner are considering will help prevent future crises, and limit their severity should they occur. This will mean stronger tools to resolve crises when they occur, including giving the government greater ability to move quickly to contain damage caused by the potential failure of a large, complex financial firm.**

**The combination of smarter, tougher regulatory standards to mitigate risks and authority to manage risks when they arise will create a system that is more stable and resilient.**

### **OUTLOOK FOR THE US ECONOMY**

**Before I try to discuss the outlook for the US economy, I was struck by what Wayne Swan said at his National Press Club**

**budget address a few weeks ago. Noting the difficulty in making economic predictions, Swan noted that the IMF in mid-2008 actually UPGRADED its projections for global economic growth for 2008 – and then had to revise downward its predictions five times over the next few months.**

**But I will draw on some recent speeches and statements by Federal Reserve Board Chairman Alan Bernanke and Vice Chairman Donald Kohn to hazard some predictions.**

**I mentioned some of the positive signs earlier. I think it is a pretty safe bet that economic activity in the US will soon bottom out and begin to tick up later in 2009, based on signs like the stabilization of the housing market and the support for demand from the stimulus package. But even after a**

**recovery begins, the economy will probably remain below its long-run potential for a while. Businesses are likely to remain cautious in hiring, which means the unemployment rate may remain high for a while even after growth resumes.**

**It is not easy to confidently predict a strong recovery either.**

**The recoveries following recessions in the early 1990s and again in 2001 were not that rapid, certainly not compared to previous post-war recoveries. We are still dealing with financial imbalances – the very imbalances that provoked the financial crisis – which will probably make this recovery more gradual. And despite the steps taken, it is likely that credit conditions will ease slowly and will continue for to act as a restraint on spending for a while longer. And savings may continue to be stronger in the short run; people show**

**signs that they will want to shore up their personal finances rather than return to spending.**

**In recent years, exports were an important element of the strength of the US economy. But the fact that the economic downturn is global means that exports will probably not offer much immediate help to domestic production.**

**Still, we believe the recovery will gain momentum over time. Credit markets will eventually improve – and we see signs of this already. Confidence will rebound. Demand will strengthen and financial markets will improve, and we will see positive feedback loops replacing the current vicious circles. Economic growth will improve and we will return to a full production economy and lower unemployment rates.**

**But I will echo Chairman Bernanke and offer an important caveat: all positive forecasts are based on the continuing repair of the financial system. A relapse would of course be a serious drag on the economy, and could stall a recovery.**

**I will end on that slightly sobering note.**